

**Office of Chief Counsel  
Internal Revenue Service  
memorandum**

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subject: Interaction Among Charitable Contributions, REMIC Excess Inclusion Income, Net Operating Losses

This Chief Counsel Advice responds to your request for assistance. This advice supersedes the two Chief Counsel Advice memoranda issued to \_\_\_\_\_ on August 28, 2008, and March 24, 2009, and may not be used or cited as precedent.

**LEGEND**

Taxpayer =

Year 1 =

Year 2 =

\$X =

\$Y =

\$Z =

## ISSUES

- (1) Does taxable income for purposes of calculating the percentage limitation under section 170(b)(2)(A) of the Internal Revenue Code ("Code") on corporate charitable contribution deductions include an adjustment for Taxpayer's excess inclusion income ("EII") under § 860E?
- (2) Is Taxpayer entitled to carry back all or a portion of its Year 1 charitable contribution deduction as part of its Year 1 net operating loss ("NOL") under § 172?

## CONCLUSIONS

- (1) In a prior memorandum, dated August 28, 2008 (attached), we concluded that taxable income for purposes of calculating the percentage limitation under § 170(b)(2)(A) means taxable income under § 63 "as adjusted for EII under § 860E." Upon further analysis, and for the reasons stated below, we now believe this conclusion was incorrect.

Taxable income for purposes of calculating the percentage limitation under § 170(b)(2)(A) means taxable income under § 63 as adjusted only for the items in § 170(b)(2)(C) and not adjusted for EII under § 860E.

- (2) For different reasons than those stated in a prior memorandum, dated March 24, 2009 (attached), Taxpayer may not carry back its Year 1 charitable contribution deduction as part of its Year 1 NOL under § 172.

## FACTS

Taxpayer is a corporation that holds a residual interest in a real estate mortgage investment conduit (REMIC). In tax years Year 1 through Year 2, Taxpayer had EII but otherwise had only NOLs. Specifically, for tax year Year 1, Taxpayer had EII in the amount of \$X, had unspecified NOLs, and made a charitable contribution in the amount of \$Y.

Taxpayer asserted that its taxable income for purposes of calculating the percentage limitation under § 170(b)(2)(A) is adjusted for EII under § 860E. Further, Taxpayer asserted that its \$Y charitable contribution in Year 1 is deductible under § 170 because \$Y is less than 10 percent of Taxpayer's EII for that taxable year, or \$Z.

In the alternative, Taxpayer argued that, if its \$Y charitable contribution is not deductible in Year 1, then the entire \$Y charitable contribution should be added to Taxpayer's unspecified NOLs and carried back (and forward) under § 172.

LAW AND ANALYSIS

Section 63(a) generally provides that “taxable income” means gross income minus the deductions allowed by Chapter 1 of the Code (other than the standard deduction). Under § 860E(a)(1) the taxable income of any holder of a residual interest in a REMIC for any taxable year shall in no event be less than the residual interest holder’s excess inclusion for such taxable year.

Section 170 provides a deduction for qualified charitable contributions. However, under § 170(b)(2)(A), deductions for charitable contributions made by a corporation is limited to a maximum of 10 percent of the corporation’s taxable income for the taxable year.

For purposes of calculating the percentage limitation under § 170(b)(2)(A), a corporation’s “taxable income” is defined as taxable income under § 63 computed without regard to—

- (1) the deduction for charitable contributions under § 170;
- (2) the special deductions for corporations allowed under part VIII (except § 248, relating to organizational expenditures), Subchapter B, Chapter 1 of the Code;
- (3) any NOL carryback to the taxable year under § 172;
- (4) section 199; and
- (5) any capital loss carryback to the taxable year under § 1212(a)(1).

Sec. 170(b)(2)(C) of the Code; § 1.170A-11(a) of the Income Tax Regulations.

Any charitable contribution in excess of the amount deductible under § 170(b)(2)(A) is deductible for each of the five succeeding taxable years in order of time under § 170(d)(2)(A), taking into account the special rule for NOLs under § 170(d)(2)(B).

Calculation of the percentage limitation under § 170(b)(2)(A) starts with “taxable income” under § 63 and then makes certain adjustments specified in § 170(b)(2)(C). Although § 860E(a)(1) also uses the term “taxable income,” it does not contain a definition of taxable income. Rather, § 860E(a)(1) specifies a minimum amount upon which Federal income tax must be paid by a residual interest holder. Importing the minimum amount taxed under § 860E(a)(1) into the definition of “taxable income” under § 170(b)(2)(A) would not further the legislative purpose of ensuring that residual interest holders are currently taxed on a minimum amount of income.

Therefore, taxable income for purposes of § 170(b)(2)(A) means taxable income under § 63 as adjusted only for the items in § 170(b)(2)(C), not taking into account EII under § 860E. As a result, Taxpayer’s taxable income for purposes of § 170(b)(2)(A) is \$0,

the amount of its Year 1 charitable contribution deduction is \$0, and the entire \$Y charitable contribution from Year 1 must be carried over to the next succeeding taxable year of Taxpayer under § 170(d)(2)(A).

Section 172(a) allows a deduction equal to the aggregate of the NOL carryovers and carrybacks to the taxable year. Section 172(c) generally provides that the term “net operating loss” means the excess of the deductions allowed by Chapter 1 of the Code over the gross income, computed with certain modifications.

Because Taxpayer’s \$Y charitable contribution in Year 1 is not a deduction allowed in Year 1, this amount is not included in Taxpayer’s NOL in Year 1 and, therefore, cannot be carried back as part of Taxpayer’s Year 1 NOL.

#### CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

If you have any questions regarding the § 170 issue, please call Nancy Lee (CC:ITA:B01) at \_\_\_\_\_; if you have any questions regarding the § 860E issue, please call Cathy Fung (CC:FIP:B02) at \_\_\_\_\_; and if you have any questions regarding the § 172 issue, please call Seoyeon Sharon Park (CC:ITA:B05) at \_\_\_\_\_.

Attachments (2)

cc:

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